

CHAPTER 5:

SUMMARY OF RECOMMENDATIONS

NEED TO WITHDRAW THE GOVERNMENT NOTIFICATION DATED JUNE 27, 1969

5.1 As long as the June 1969 notification is operative, RBI would have to continue to take up with the Government to issue necessary notification exempting, such of those entities as deemed necessary by the Bank, from the prohibition contained in the notification. It will not be possible for most intending parties (other than the few permitted) to legally participate in repos unless the Notification is withdrawn by the Government. Hence, the first basic legal requirement for developing repos is to withdraw the Government Notification dated June 27, 1969. (Para 4.2)

RBI NEEDS TO ACQUIRE REGULATORY POWERS UNDER 29A OF SCR ACT.

5.2 Repo being short term money market instrument, is being used for smoothening volatility in money market rates by central banks through injection of short term liquidity into the market as well as absorbing excess liquidity from the system. Regulation of repo market thus becomes a direct responsibility of RBI. As expansion of the repo market with wider participation and variety of instruments would require RBI to have enhanced regulatory powers over the debt market there is need to amend Section 29A of SCR Act. to enable the Government to delegate regulatory powers for of trading in Government Securities and other debt instruments. (Para 4.4)

NEED TO REPLACE PUBLIC DEBT ACT, 1944

5.3 The Group recognises the legal impediments in the way to electronic transfer of gilt securities which is not possible under the Public Debt Act, 1944 and the need to effect early replacement of the Public Debt Act by the proposed Government Securities Act has assumed great expediency. The Group urges that immediate steps should be taken to resolve the legal and procedural difficulties in the way to achieve a modern market infrastructure It may be worthwhile to take due cognizance of the changing face of securities settlement systems, the world over with the use of information technology.(Para 4.5)

"OVER THE COUNTER" AND "TRIPARTITE" REPOS TO EXPAND THE MARKET

5.4 The Group is of the view that keeping the needs of the market participants a system of "over the counter" and "exchange traded" repos with adequate checks and controls could be introduced, as under:

- (i) All entities who have SGL Account and Current Account with RBI may be allowed to undertake "over the counter" repos and reverse repos in all Government securities (including those issued by the State Governments).
- (ii) For the present, such repos may be restricted to SGL Accounts at Mumbai and in due

course with successful linking of all RBI offices, it could be extended to other RBI centres.

- (iii) All entities including corporates may be allowed to undertake repos and reverse repos in all Government securities, PSU bonds, Private Corporate Debt Securities and bonds issued by All India Financial Institutions provided:
 - (a) the debt instruments are held in dematerialised form in a depository; and
 - (b) the transactions are undertaken through approved stock exchange with a well capitalised clearing corporation functioning as legal counter party.

Transactions under (iii) above, involving triparty could be permitted provided:

- (a) the triparty agent is a well capitalised Clearing Corporation licensed to function as a legal counterparty in all such transactions; and
- (b) where such an agency would define acceptable securities from within the specified broad categories as mentioned above, execute required haircuts, do daily marking to market, ensure that all participants maintain adequate collateral at all times, the quantity traded is in standardised lots and the settlement is done under "novation", maintaining anonymity of counterparties all the time. (Para 4.19)

UNIFORM ACCOUNTING PRACTICES TO BE INTRODUCED

5.5 In order that there is uniform accounting treatment and sufficient transparency, the Group has accepted continuance of the "buy-sell back repo concept" while has suggested its own accounting norms for repos so that there is uniformity in approach towards accounting in general and applying haircuts/margins, booking of capital gains/loss and separation of the interest paid/received in the transaction, in particular. The uniform accounting treatment of repos is accordingly placed at Annexure II.(Para 4.27)

DAY LIGHT OVERDRAFT FACILITY FOR CURRENT ACCOUNT HOLDERS REQUIRED

5.6 As regards settlement, the existing system of end of the day DVP cannot be considered risk free due to bottlenecks in movement of securities and cash, as explained above. A system of provision of day-light overdraft to the current account holders by RBI may be thought of to avoid such eventuality.(Para 4.29)

GUIDELINES FOR CONSTITUENTS' SGL ACCOUNT OPERATIONS TO BE ISSUED

5.7 In the context of gradual deepening of the Government securities market and the policy to promote the retail segment of the market, it is felt expedient to frame a set of guidelines governing the maintainance of the Constituents' SGL Accounts by these entities. The Working Group has, accordingly suggested outline for the draft guidelines providing for obligations and code of conduct in dealing with the Constituents' securities including transparency and safety which is placed at Annexure III. This could be finalised after discussion with representative self regulatory organisations of the market participants. (Para 4.33 and 4.34)

DATE OF DEAL AND SETTLEMENT TO BE SPECIFIED

5.8 To avoid differences in practices followed it would be desirable to stipulate deal date and settlement date. At present deals undertaken take, often more than stipulated number of days for execution and settlement. In order that there is no confusion deals can either be settled on the same day or the next day of the deal and this should be clearly indicated in the contract/terms of deal to ensure that there is no confusion/variance in settlement date of repos. (Para 4.35)

A MASTER RE-PURCHASE AGREEMENT FOR REPOS TO BE INTRODUCED

5.9 There is need for, as done internationally, a comprehensive master repurchase agreement which allows obligations under all outstanding repos to be set off against each other upon default or insolvency of the counterparty. Working Group has attempted a draft document which could be modified suitably to meet actual requirements in repo transactions. The Draft Master Purchase Agreement placed at Annexure IV has provisions for absolute transfer of title of securities (including any securities transferred through substitution or mark to market adjustment of collateral). (Para 4.38)

CODE OF CONDUCT FOR REPOS TRANSACTIONS TO BE LAID DOWN

5.10 A code of conduct would include issues participants should address before undertaking repo transactions, legal agreements in prevalence, margins, marking to market, exposure limits on counterparties, custody of collaterals, right to declare a counterparty in default, confirmation of deals, matters to be covered before trading with a new counterparty, information to be exchanged at point of trade etc. The Group has included a draft of a code of conduct which has been included as a part of this report for the benefit of the market practitioners. (Para 4.39).

REPO MARKET TO BE SUPERVISED AND CLOSELY MONITORED BY RBI

5.11 The memories of the irregularities committed in the Government Securities Market is still very fresh in the minds of the market participants and the regulators. As more participants and instruments are made eligible for undertaking repo transactions RBI may like to monitor the size, growth and orderliness of the repo market. As money market on line dealing system is installed and made operative it should become possible for RBI to monitor the market online focusing on participants, market rates, trading patterns etc. (Para 4.40)

ROLL OVER OF REPOS TO BE PERMITTED

5.12 Repos being in the nature of collateralised borrowing should be allowed to be rolled over with revaluation at the time of roll over at rates of interest/value of securities in alignment with prevailing market rates. Further, since there is no maximum period specified for repo by RBI, the absence of perception of short term interest rate for longer period repo horizon inhibits the parties to enter into repos for period longer than a fortnight. The rollovers could be for any period and should not have any relationship with the original contract period. (Para 4.42).

MAXIMUM ELIGIBLE DURATION OF REPOS TO BE CLARIFIED

5.13 There are at present no restrictions on the duration of repos.

Effective October 31, 1998, RBI has already withdrawn the restriction of a minimum of 3 days for a repo transaction which has been operative. The Group, however, gets an impression that there is an RBI stipulation on the maximum number of days for which Repos could be undertaken. A clarification stating that such restrictions do not exist would help the market. (Para 4.43).

5.14 A summary of the Report was earlier circulated among the members of the Advisory Committee. The modifications suggested by the members of the Committee have been duly incorporated in the revised Report of the Sub Group.

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